

(3) The patent is considered to be unenforceable; or

(4) The patent is expired.

(b) Care should be exercised in determining reasonableness when the royalties may have been arrived at as a result of less-than-arm's-length bargaining; e.g., royalties—

(1) Paid to persons, including corporations, affiliated with the contractor;

(2) Paid to unaffiliated parties, including corporations, under an agreement entered into in contemplation that a Government contract would be awarded; or

(3) Paid under an agreement entered into after the contract award.

(c) In any case involving a patent formerly owned by the contractor, the royalty amount allowed should not exceed the cost which would have been allowed had the contractor retained title.

(d) See 31.109 regarding advance agreements.

#### **31.205-38 Selling costs.**

(a) "Selling" is a generic term encompassing all efforts to market the contractor's products or services, some of which are covered specifically in other subsections of 31.205. The costs of any selling efforts other than those addressed in this cost principle are unallowable.

(b) Selling activity includes the following broad categories:

(1) *Advertising.* Advertising is defined at 31.205-1(b), and advertising costs are subject to the allowability provisions of 31.205-1(d) and (f).

(2) *Corporate image enhancement.* Corporate image enhancement activities, including broadly targeted sales efforts, other than advertising, are included within the definition of public relations at 31.205-1(a), and the costs of such efforts are subject to the allowability provisions at 31.205-1(e) and (f).

(3) *Bid and proposal costs.* Bid and proposal costs are defined at 31.205-18 and are subject to the allowability provisions of that subsection.

(4) *Market planning.* Market planning involves market research and analysis and general management planning concerned with development of the contractor's business. Long-range market

planning costs are subject to the allowability provisions of 31.205-12. Other market planning costs are allowable.

(5) *Direct selling.* Direct selling efforts are those acts or actions to induce particular customers to purchase particular products or services of the contractor. Direct selling is characterized by person-to-person contact and includes such efforts as familiarizing a potential customer with the contractor's products or services, conditions of sale, service capabilities, etc. It also includes negotiation, liaison between customer and contractor personnel, technical and consulting efforts, individual demonstrations, and any other efforts having as their purpose the application or adaptation of the contractor's products or services for a particular customer's use. The cost of direct selling efforts is allowable.

(c) Notwithstanding any other provision of this subsection, sellers' or agents' compensation, fees, commissions, percentages, retainer or brokerage fees, whether or not contingent upon the award of contracts, are allowable only when paid to bona fide employees or established commercial or selling agencies maintained by the contractor for the purpose of securing business.

[68 FR 43872, July 24, 2003]

#### **31.205-39 Service and warranty costs.**

Service and warranty costs include those arising from fulfillment of any contractual obligation of a contractor to provide services such as installation, training, correcting defects in the products, replacing defective parts, and making refunds in the case of inadequate performance. When not inconsistent with the terms of the contract, service and warranty costs are allowable. However, care should be exercised to avoid duplication of the allowance as an element of both estimated product cost and risk.

[48 FR 42301, Sept. 19, 1983, as amended at 66 FR 2131, Jan. 10, 2001]

#### **31.205-40 Special tooling and special test equipment costs.**

(a) The terms *special tooling* and *special test equipment* are defined in 45.101.